Railroad Corporate Accounting During Federal Control

BY FRANK NAY

Vice-President and Comptroller

Chicago, Rock Island and Pacific Railway Co.

An address delivered at the 31st annual meeting of the Railway Accounting Officers Association New York City, June 11 and 12, 1919

THIS PAMPHLET IS PUBLISHED AND DISTRIBUTED BY THE
RAILWAY ACCOUNTING OFFICERS ASSOCIATION
1116 WOODWARD BUILDING
WASHINGTON, D. C.

RAILROAD CORPORATE ACCOUNTING DURING FEDERAL CONTROL

Frank Nay

The United States Government took possession of the railroads of the United States under proclamation of President Woodrow Wilson, at 12 o'clock noon, on December 28, 1917, but for the purposes of accounting, the possession dated from 12 o'clock midnight on December 31, 1917. Mr. W. G. McAdoo, Secretary of the Treasury of the United States, was appointed by the President, Director General of Railroads, and Mr. McAdoo's General Order No. 1, issued under date of December 29, 1917, provided that all officers, agents and employes of the transportation systems, should continue in the performance of their regular duties, reporting to the same officers as theretofore, and on the same terms of employment. General Order No. 2 issued on the same date, reads as follows:

General Order No. 2.

Washington, D. C., December 29, 1917.

To the Chief Executives of the Railroads:

Pursuant to the authority vested in me by the President of the United States in his proclamation of December 26, 1917, wherein it was stated that for purposes of accounting, possession and control of the railroads shall date from 12 o'clock midnight on December 31, 1917, you are notified that, until otherwise directed, no changes in the present methods of accounting as prescribed by the Interstate Commerce Commission will be required. The accounts of your respective companies shall be closed as of December 31, 1917, and opened as of January 1, 1918, in the same manner as they have heretofore been handled at the close of one fiscal period and the beginning of another, and in the same manner that you should have handled your accounts had the Government not taken possession and control.

William G. McAdoo,
Director General of Railroads.

Under that general order, the railroad accounting officers handled both corporate and Federal accounts; in fact, at that time they had no knowledge as to the difference between a corporate account and a Federal account. They continued, for several months, to perform their duties exactly as prior to Federal control. January 1st being the beginning of the calendar year and of the fiscal year established by the Interstate Commerce Commission, was the most propitious day on which to inaugurate the period of Federal control. Naturally the

accounts for the year 1917 separated themselves from the accounts for the year 1918, barring certain over-lapping items which will be considered later.

Corporate and Federal Accounts.

For some months there was indecision as to whether or not it was necessary to make a complete separation of the accounts, such as has since been decided upon. The undersigned was asked by an official of the United States Railroad Administration if he could fairly and impartially keep the accounts of the road which he represented, for the corporation and for the Director General, and give a square deal to both. The answer was in the affirmative, and reference was made to the many joint agencies of various kinds existing all over the United States, filled by men who have for years been serving two or more railroad companies, and have been giving each railroad company served, a square deal. However, further consideration of the matter led the Administration officials to the conclusion that it was desirable and necessary to have not only a complete separation of the accounts between the corporate accounts and those of the Administration, but that they should be administered by separate accounting forces, in charge of separate accounting officers; or, to put it another way, the Administration desired to have their accounts kept by men who were 100% Administration, and who had no official connection with the corporations. With this in mind, General Order No. 17 was issued, under date of April 3, 1918. This order provided for a complete separation of the accounts of the corporation from those of the Director General, and required that they be written in separate sets of books. This was done, and when the work was completed, the corporate books were turned over to the corporation, and it was then necessary for the corporation to have an accounting officer who would take charge of the corporate books, as the accounting officers of the Administration were prohibited from keeping them further without special permission from the Administration.

Corporate Accounting Departments Organized.

About July 1, 1918, the separation of the sheep from the goats began. At that time Federal Managers were appointed for the various railroads, complete Federal organizations were established and the Federal officers were required to sever all

connections with the railroad corporations, as officers, directors, or otherwise. That action obliged the corporations to create organizations entirely separate and distinct from the Federal organizations. One of the first essentials of the separate corporations was adequate provision for corporate accounting, because it was extremely important that the accounts of the corporation should be given proper attention. As illustrating how the corporate executives felt, I quote the following from a letter dated October 26, 1918, from Mr. Samuel Rea, President of the Pennsylvania Railroad Company, addressed to a number of Presidents of other large railroad companies, in connection with the proposed formation of a corporate railway accounting officers' conference:

> You will appreciate that the contract is in large part an accounting matter. It lays down the general basis and principles of the relation with the Government, but the details for carrying it out will devolve largely upon the Accounting Officers.

I imagine very few corporate accounting officers at first had any grasp upon the conditions and situations which confronted them. I confess to you that when I was appointed corporate accounting officer, or rather, retained in that position, because no change was made in my title and no change in my duties, except the separation of accounts relieved me from the detail of the operating accounts—I said to my assistant, something like the following: "Joe, I believe you and I can handle the corporate accounts for the Rock Island; there will not be very many journal vouchers, and we may have to get a clerk or two to work on the subsidiary accounts and check the lap-overs, but you and I can do the general work without any difficulty at all; in fact, I rather welcome the idea of getting a chance to make some entries on the books again; it has been so many years since I actually took my pen in hand to make entries on ledgers."

Today I have in my corporate accounting office for the Rock Island, 34 clerks; they are all kept busy and many of them are working overtime. By actual count we record just as many journal vouchers on our books as prior to Federal control. Up to this time I have not personally made any entries on the books and it looks as if I would not be able to do so during Federal control; in fact, I give you my word that I have never worked harder in my life than during the last year, and I may add, I have never had less to show for hard work.

In taking up this corporate accounting work, we had an entirely new proposition. None of us had had experience with a similar accounting situation, and we had to blaze the trail. We were also confronted with the difficulty of obtaining adequate and competent help. The very cream of the young railroad men of our country had eagerly offered the supreme sacrifice to help win the war, and there was a great shortage in railroad accountants.

Compilation of Standard Return.

One of the first things to which the attention of the corporate accounting officer was applied, was the compilation of data to demonstrate prior to the signing of the contract covering Federal control, whether or not the average net railway operating income as reported to the Interstate Commerce Commission for the three years ended June 30, 1917, was the true income for that period. It should be stated that the President's proclamation hereinbefore referred to, was followed by an Act of Congress, approved on March 21, 1918, which, among other things, fixed the compensation to be paid to the railroad corporations for the use of their property during Federal control, at the average net railway operating income for the three-year period ended June 30, 1917, called the "Test Period." It is a matter of common knowledge that owing to the voluminous details, the frequent negotiations of contracts or arrangements which are made effective prior to the date on which the agreements are executed, construction of additional lines and additions and betterments, congestion of traffic, etc., the net railway operating income as reported to the Interstate Commerce Commission for any period, is not an exact figure, such as contemplated by the President and Congress in their utterances. If the figure for any such period should be revised and completed in accordance with later and more accurate information, the net income might be greater or less than the amount originally stated. It is assumed that when the President issued his proclamation and when Congress passed the Act of March 21, 1918, fixing as the compensation for the use of the railways, the average annual net railway operating income for the three years ended June 30, 1917, the actual net income as nearly as might be ascertained without completely re-working all of the detailed figures, was intended. In the case of carriers where that net figure was over-stated, due to the omission of some charge or to an ex-

cessive credit, which would be adjusted in a subsequent period, unless adjustments are made, such carriers would receive a rental in excess of the amount intended by the President and by Congress. In the case of a carrier whose net income as stated to the Interstate Commerce Commission for the period named, was less than the actual figure, due to items similar to those hereinbefore mentioned, such a carrier would be underpaid unless proper adjustment was made. As the Interstate Commerce Commission was required to certify to the President, the average net railway operating income for the three years ended June 30, 1917, it would seem natural that the Interstate Commerce Commission would make an effort to locate the relatively important items which should be adjusted and thus produce a net figure which would more nearly represent the actual net railway operating income than the one which was reported to the Commission.

It should be said right here that when the statement is made that the net operating income reported to the Commission, is not the actual, the impression must not be created that any intentional omissions or errors were made or that the net figure that was stated was intentionally greater or less than the actual, but owing to the large volume of items entering into the net operating income of the carrier during the year, or during the three-year period, and the complications in connection therewith, it is a practical impossibility to state the net income of the carrier on an actual basis within the time prescribed for rendering the reports.

Along in the summer of 1918, the Interstate Commerce Commission became aware that certain carriers had included in their accounts, subsequent to June 30, 1917, certain Adamson law payments, which accrued prior to June 30, 1917, and should have been charged against the expenses of the three-year period ended June 30, 1917. Further, they were aware of the fact that under the income or war tax law of October, 1917, the carriers could not possibly have included the taxes under that law which accrued during the first six months of the year 1917, in the accounts for that period. The very fact that the law was not enacted until more than three months after the close of the period, precludes the possibility of including the figures within the period. Therefore, the Interstate Commerce Commission sent out a communication to the chief accounting officers of the various carriers, requesting them to modify their previous reports of the net railway operating income for the three years ended June 30, 1917, by

deducting therefrom such omitted Adamson law payments as had accrued within that period, and also by deducting therefrom one-half of the war taxes under the Act of October, 1917, for the year 1917. This action was commendable and in harmony with the spirit to determine a figure for the net railway operating income for the three years ended June 30, 1917, which should be as nearly as practicable the actual figure for that period. The carriers responded with the corrections requested, and then later, certain carriers called to the attention of the Interstate Commerce Commission items which were erroneously included as a charge against the net income of the test period, and to revenue which was erroneously omitted from that of the test period; the adjustments requested would have the effect of increasing the net railway operating income for the test period. However, the Interstate Commerce Commission declined to make any further adjustments unless it could be shown that the accounting rules of the Interstate Commerce Commission had been violated. The Interstate Commerce Commission initiated the move to decrease the net railway operating income by deducting therefrom the two items mentioned—the omitted Adamson law payments and the one-half of the 1917 war taxes, neither of which constituted a violation of the accounting rules of the Interstate Commerce Commission, but the Commission has so far declined to make adjustment of similar items subsequently brought to their attention.

Lap-overs..

Under General Order No. 17, certain items affecting the income accounts of the corporations prior to midnight of December 31, 1917, were classed as lap-overs. On the expense side, these lap-overs were very clearly defined by General Order No. 17, and accounting bulletins and circulars. They referred to all payments by the Director General for expenses which were incurred prior to January 1, 1918, which if they had been paid prior to Federal Control, would have been charged to operating expenses or income account of the corporation prior to such control. In other words, the lap-over expense items were allocated according to the date on which the service was performed or the liability incurred.

The general orders and circulars of the U. S. Railroad Administration provided that such lap-overs would be paid by the Administration, and charged against the railroad corporations, and that the railroad corporations would simultaneously

credit the U. S. Railroad Administration on the corporate books. This is an entirely equitable method of handling these lap-overs as the Administration had taken over the cash on hand January 1, 1918, and had collected all operating funds accruing to the corporations on and after that date; in fact, the Administration collected all moneys, whether operating or corporate, that accrued to the corporations for several months after the beginning of Federal control, and naturally, it was incumbent upon the Administration to pay the liabilities of the corporations.

On the revenue side, however, the lap-overs have not been clearly and equitably defined. In General Order No. 17 it was provided that the Administration would continue to revenue the freight, passenger and other traffic in the same manner that the corporation had accounted for such revenue, taking into the Administration treasury, the revenue that would have accrued to the corporation in the months during Federal control. As to passenger service, the revenue on which is accrued largely on a forwarded basis the corporations are credited with more than their proper proportion of the revenue on lap-over passenger traffic. The average journey per passenger is shown in the reports of the Interstate Commerce Commission to be anywhere from 20 miles to 100 miles in the different sections of the United States, and therefore, on the average, because of the short journeys and because passengers do not become congested at terminal points, like freight, the method of determining passenger lap-overs as prescribed in General Order No. 17 does not miss the mark very far, but as heretofore stated, it is not exact, and is on more or less of a hit-or-miss basis. However, neither the revenues of the corporations nor the revenues of the Administration would be seriously affected by the application of General Order No. 17 to the passenger business, assuming that exactly the same method of ticketing passengers and of accounting for passenger revenue will prevail at the end of Federal control as at the beginning of Federal control.

As to the freight traffic, the method proposed in General Order No. 17 of revenuing freight at the beginning, during and at the end of Federal control, in accordance with the practices of the carrier prior to Federal control would cause certain carriers or corporations to suffer heavy losses in their revenues, and the U. S. Railroad Administration to have the advantage of similar gains. At the time that the railroads were taken over by the Administration, freight was interrupted

en route and congested at many terminal points. This was due to the increased movement of traffic on account of transportation for the War and Navy Departments and by orders given to expedite the movement of certain classes of traffic, which resulted in the delay and congestion of other classes of traffic. In fact, at December 31, 1917, there was an unusual congestion and freight was delayed en route to a much greater extent than in the ordinary course of business, and the accrued earnings on such freight delayed en route, amounted to many millions of dollars. In the case of the few railroads which accrue their freight revenues on the "forwarded" basis, that is to say, those which put into their revenue and income account the earnings when the freight starts on its journey, these congestions would have no effect, but the large majority of roads which accrue their revenue on a "received" basis, that is to say, those which credit their revenue or income account when the freight arrives at destination and the transportation service is complete and the contract fulfilled, would suffer a very large loss of revenue under the provisions of General Order No. 17. Of course, the losses to the corporations would be minimized, if the congestion at the close of Federal control should be as great as at the beginning of Federal control—a condition which is scarcely possible because at the close of Federal control, under peace conditions, there will not be the enormous volume of traffic and priority orders that caused the congestion and delay which existed at the beginning of Federal control. However, as to lap-overs, that order was framed on an unsound accounting basis, and provided a hit-or-miss division of the freight revenue between prior or corporation account, and the accounts of the Federal Administration. This condition was later modified by the contract, see Section 4, paragraph (b), and by accounting circular No. 53 of December 2, 1918. The accounting circular No. 53 is still on a hit-or-miss basis, although it does provide for an adjustment of certain delayed carload shipments which had reached destination prior to Federal control but the accounting delayed until during Federal control. However, accounting circular No. 53 does not take care of the large number of shipments—carload and less than carload—that were delayed in transit which had not reached destination at December 31, 1917. Take for example a carload shipment moving via the Baltimore and Ohio Railroad from Chicago to Baltimore, which reached Pittsburg in December, 1917, and lay there until, say January 10, 1918, when it moved out to destination, the settlement being made on the "received" basis.

The Baltimore and Ohio Railroad included in its operating expenses, the cost of transporting that shipment from Chicago to Pittsburg, but never have, and according to the present attitude of the Railroad Administration, never will receive a dollar for such transportation. An offset will result at the end of Federal control if a similar car is en route from Chicago to Baltimore, reaches Pittsburg just prior to the end of Federal control, and lays there until after the end of Federal control, and then moves to destination after Federal control, the revenue being taken into the accounts of the corporation after Federal control. If a sufficient number of such cars move just prior to the end of Federal control, to produce the same lap-over revenue as that produced by delayed cars which moved just prior to the beginning of Federal control, there would be an offset, but considering the congestion that existed at the time the railroads were taken over, and that probably there will be no congestion at the end of Federal control, it is inconceivable that there will be anything like the number of such cars en route at the end of Federal control as at the beginning of Federal control. It has been urged that to make a separation of the accounts between the carriers, would require additional clerical expense, and of course, it is true that to prepare an account accurately requires more clerical work than to guess at it. It is my judgment that the railroads as a whole will lose millions of dollars because of the failure to separate the freight revenues at the beginning and at the end of Federal control on the basis of the service performed; that is to say, take the case of the shipment, Chicago to Baltimore, hereinbefore referred to; the revenue from Chicago to Pittsburg should have been credited to the corporation because the expense of that haul was charged to the corporation, and only the revenue from Pittsburg to Baltimore should have been credited to the Federal Administration because the Administration paid the expense of that haul. The increase of 25% in freight rates would require that 80% of the freight that was delayed en route at December 31, 1917, should be delayed en route at the end of Federal control; that is to say, where there were 100,000 lap-over cars from certain points to certain points delayed in transit at certain points, at December 31, 1917, there should be 80,000 lap-over cars from the same points to the same points, delayed in transit at the same points, at the end of Federal control in order to give the corporation an erroneous credit which would offset the erroneous credit given the Railroad Administration at the

beginning of Federal control. If there should be less than 80% of such cars delayed in transit at the end of Federal control, the corporation loses revenue; if there should be more, it will gain revenue, but such methods are unbusinesslike and are not good accounting methods. I daresay that the accounting between the U. S. Railroad Administration and the War Department, Navy Department, or any other department of the same Government, is not conducted on a basis as loose as that. Of course, as to the less than carload shipments, the average haul is shorter, the amount of money involved is smaller, and the expense of separation is greater. The majority of the less than carload shipments of freight are handled on the "received" basis, while the passenger business is handled on the "forwarded" basis. The less than carload business might be ignored and any loss to the corporation thereon be considered as an offset against the gain in the passenger business. In those two cases, the amount of revenue involved would be comparatively small, and although it is unbusinesslike not to make any attempt at a separation on the basis of service performed, yet accountants must be practical, and where the expense is liable to be more than the amount involved in a separation of accounts between the railroad and the Government during the time of war, there would be no serious objection to waiving the strict accounting practices in such cases. However, the expense of apportioning the revenue on carload shipments substantially in accordance with the service performed, would not be seriously burdensome and where millions of dollars are involved, good accounting and businesslike methods should not be sacrificed.

Another question regarding these lap-overs relates to the proper accounts to be charged and credited by the corporation after the amounts have been determined. A bulletin was put out by the Committee on General Accounts of this Association, stating that Mr. Alexander Wylie, Chief Examiner of Accounts, of the Interstate Commerce Commission, had ruled that these lap-over expenses and lap-over revenues should be charged and credited to the income accounts of the carriers, while a large number of railroad accounting officers maintain that they should be charged and credited to the profit and loss accounts of the carriers.* The theory on which the instructions to charge and credit the income account is that *if* the corporation had been operating the properties, these items would have been taken into the income account under the

*At the meeting at which this paper was read the Railway Accounting Officers Association voted in favor of charging and crediting these prior items to Profit and Loss.

head of operating expenses, operating revenues, etc. In other words, the decision is based on an "if" statement, but the "if" goes the wrong way. The corporations are not operating their properties and have not operating expenses, operating revenues, etc., in which to include those items. Furthermore, the corporation's income account is based on the average net railway operating income for the test period, which theoretically is complete and represents the complete income for those three years including the lap-overs from the beginning of the period and excluding the lap-overs at the end of the period. An average of three complete years makes the complete income account so far as the operating accounts included in the standard return are concerned. Hence, any lap-overs added to the income account or deducted therefrom, cause a misstatement of the income of the corporation.

Another reason for requiring such items to be debited and credited to the income account of the corporation, was to offset the corresponding debit or credit to the income account of the Administration, so that when the two accounts were put together, these lap-over debits to expenses and credits to revenues would disappear in the consolidated account, offsetting each other. However, I have learned recently that it is the intention of the Administration, and I want to express my commendation of their proposed practice, not to charge and credit these items to the Administration income account, but to set up reserve accounts which will take care of similar items that will be charged and credited to the Administration after Federal control. It is evident, of course, that at the end of Federal control there will be lap-overs in expenses which must be charged back to the Federal Administration, and lap-overs in revenues which must be credited back to the Administration. If these items are put into the income account of the Administration currently, it will be necessary for the lap-overs to be put into the income account of the Administration a long time after the close of Federal control, which might prove very embarrassing to the Administration because they will run into millions of dollars. It seems to me to be very wise, good business and sound accounting for the Administration to charge and credit these lap-over items to a reserve account against which they will charge and credit similar items after the end of Federal control.

Corporate Transactions.

Certain debits and credits are made to the corporations by the United States Railroad Administration under the head of

"Corporate Transactions." These debits and credits represent payments or receipts by the Federal officers which are chargeable or creditable to accounts outside of those comprised in the standard return. Such debits and credits should be carefully examined by the accounting officers to determine whether or not they are properly chargeable or creditable to the corporations, and the principle to govern is whether or not the item is properly chargeable or creditable to an account which is not embraced in the standard return.

Verification of Accounts with U. S. Railroad Administration.

One of the principal duties in connection with corporate accounting is to check the debits and credits made against the corporation by the U. S. Railroad Administration, to determine the accuracy of the lap-overs, the charges for additions and betterments, the charges against corporate transactions, and in fact, all debits and credits made against or in favor of the corporation, in order to see that the corporation's revenues and income are properly protected so far as its accounts with the United States Railroad Administration are concerned. Of course, this does not mean that the corporate accounting officer is to neglect in any way whatever his usual functions with regard to strictly corporate transactions which are not handled by the Federal Railroad Administration, but this section of the paper is to lay emphasis on the necessity of checking the accounts with the Federal Administration. Not only should the items which are charged and credited to the corporation be thoroughly audited and their accuracy completely determined, but the accounts of the Federal books should be examined with a view of determining whether or not omissions have occurred, which would affect the accounts with the U. S. Railroad Administration.

As to the lap-over items, the principal work will be in the freight and passenger departments, and that work diminishes as time goes on, because naturally there would be more lap-overs in January, 1918, than in any subsequent month, and so on until the present time, the lap-over items are very small. However, as most of the railroad corporations did not get their corporate accounting departments on a working basis until the latter part of 1918, it is probable that the work of checking the lap-over debits and credits and the accounts to determine whether omissions have occurred, has not been completed to date by very many carriers. For this purpose, first-class accountants should be employed. Any lack of ability on the part of the accountants checking the accounts with the

Government may result in heavy losses in revenues to the corporation. It is much better to defer the work to some later day than to employ inferior accountants for that kind of work. In the event an inferior accountant is, through an error in judgment, employed on this work, he should be taken off of it just as soon as his lack of capability is discovered. In such a case, no squeamish notions should be allowed to interfere with the duty of the accounting officer, which is to protect the revenues of the corporation which he serves. It is unnecessary to point out to the corporate accounting officers the details of this checking, and the time for this paper is too short for that, even if the necessity existed. The paper would not be complete without mentioning the subject and emphasizing its importance, and the necessity for the most thorough auditing by competent accountants.

Another item of verification which will not diminish during Federal control is the net charge to additions and betterments made to the property by the United States Railroad Administration. The accounting rules of the Interstate Commerce Commission describe in a very complete and accurate manner the divisions between operating expenses and additions and betterments. So many additions and betterments jobs involve charges to operating expenses, such as renewal of bridges, renewal of buildings, and other structures and appurtenances that it is very easy to charge something to the additions and betterments that should be charged to operating expenses. The corporate accountant should bear in mind that a dollar charged to additions and betterments on a job approved by the corporation means that the corporation must repay that dollar to the United States Railroad Administration, and that a dollar charged to operating expenses in connection with additions and betterments jobs will be borne by the Administration; therefore, if ten dollars, or one hundred dollars, or one thousand dollars are erroneously charged to additions and betterments instead of to operating expenses, the corporation thereby suffers a direct loss for which the accounting officer is directly responsible.

The rules of the Interstate Commerce Commission, which under the contract with the U. S. Railroad Administration govern the separation of expenditures between operating expenses and additions and betterments, should be restudied very carefully in order that the provisions of the contract may be carried out strictly and that the corporation will not suffer loss of revenue.

As to the interest on additions and betterments, pro and con, that is the interest charged by the Administration for advances to the corporation for additions and betterments until such advances are repaid, the interest allowed to the corporation during construction as a part of the cost of the additions and betterments, and the interest on such expenditures creditable to the corporation from the time the facilities are put into operation until the end of Federal control, the rules have not yet been completely covered by general orders or circulars of the Railroad Administration. It seems to me that the fairest and least expensive way of computation would be to compute such interest quarterly. The compensation to the carriers is payable quarterly, and interest does not begin to accrue on such unpaid compensation until after the end of the quarter during which it accrues; that is to say, the compensation payable to a carrier which was earned in January, February and March, 1918, and which is supposed to be payable out of the revenues collected by the Administration during those three months, if unpaid, does not begin to draw interest until April 1, 1918. Theoretically, it is out of this compensation that the Administration pays for additions and betterments, lap-over items and corporate transactions, and inasmuch as interest does not begin to accrue on the compensation or on lap-over items until the end of the quarter, it would seem perfectly fair and reasonable to begin to accrue interest on expenditures for additions and betterments against the corporation at the end of the quarter, instead of at the end of any one month. If interest on advances for additions and betterments and interest during construction should begin to accrue at the end of each quarter, then it would also be fair to begin to accrue interest on completed jobs at the beginning of the quarter following that in which the facilities are put into operation. That is to say, a track or facility which was completed any time during the quarter ended June 30th, would begin to bear interest on its cost in favor of the corporation on July 1st, regardless of whether the facility was put into operation in April or in June. It would seem that the payment of compensation quarterly establishes a principle which should be observed in connection with additions and betterments expenditures both in favor of and against the corporation. Such a method would also simplify the computation, thereby reducing clerical work.

In connection with additions and betterments, it is recommended that the corporate accounting officers keep a separate

account of those not approved by the corporation, and that the U. S. Railroad Administration be credited on the books of the corporation only with the amount that has been approved by the corporation. It is recommended that the entire expenditures, whether approved or disapproved by the corporation, should be charged to additions and betterments because the tracks, structures, etc., have been actually added to the property. However, on the credit side of the balance sheet it is recommended that those expenditures covering jobs that are disapproved by the corporation, shall be carried under the head of Miscellaneous Credits, which include items temporarily carried under that head until sufficient information is received to determine the account in which they should finally rest.

Up-Keep.

Another item which may receive serious attention by accounting officers is the matter of up-keep road and up-keep equipment. The contract provides that the Director General shall return the property at the end of Federal control in substantially as good condition as at the beginning, and in substantially as complete equipment. It contains a proviso, however, that if the Director General shall expend and charge for labor, material, depreciation and retirements per annum as much in the aggregate as was expended during the test period by the corporation, it shall be taken as a fulfillment of the obligation to return the property in as good condition and complete equipment as at the beginning of Federal control. If the Administration takes advantage of this proviso, then the matter of settling the up-keep section of the contract becomes largely an accounting proposition, in which the corporate engineers may render substantial assistance. If the Administration does not take advantage of this proviso but stands on the original proposition that the property shall be returned in as good condition and complete equipment as at the beginning of Federal control, then the up-keep section of the contract becomes a matter almost exclusively for determination by the corporate engineers and executive officers for the reason that the condition of the property at the beginning and at the end of Federal control is the thing to be determined, and that must be largely by actual knowledge of the conditions and by engineering records.

Property Retired.

Another important item to be looked after is that of prop-

erty retired and the proper credit to the corporation therefor. Under the existing orders of the Interstate Commerce Commission, also of the U. S. Railroad Administration, the corporation is credited for property retired on the basis of the original cost, while the contract provides that the credit shall be on the basis of the value of the property at the time of retirement. It was necessary to have some working basis so as not to delay the accounting for property retired and cause a large accumulation, and so the original-cost basis was adopted temporarily until some other basis is substituted. The matter has received much consideration, but has not been finally determined. Each accounting officer should see that this matter of the proper credit for property retired, is in the end allowed. As depreciation is only an estimated amortization of the retirement charge, whatever allowance or equation is made in connection with retirements should also be made in connection with the charges for depreciation of property still in existence. Of course, in the case of property that has been retired, the amount that is finally determined upon as the retirement credit to the corporation, will be reduced by the amount previously credited for depreciation, and the final credit will be correct, but as to depreciation on property which has not been retired, some equation factor will undoubtedly be found to increase that credit in substantially the same ratio that the credit for retirements is increased. This equation of retirements and of depreciation enters into the up-keep proposition which has not been determined as between the corporations and the Railroad Administration, but the accounting officers should be careful to see that promptly upon such determination, the accounts are properly adjusted from the original-cost basis on which the credit was previously written, to the agreed basis.

In this connection it is suggested that careful attention should be given to the credit for retirements just prior to and subsequent to the beginning of Federal control. As, for example, suppose a building was retired in the accounts of a carrier in December, 1917, but the actual work of constructing the new building was not commenced until January, 1918. If such instances are not carefully watched, the corporation will be charged with the entire cost of the new building as additions and betterments, and will not receive credit by the Railroad Administration for the value of the old building which was retired. The reverse situation might occur; that is to say, the construction of a new building might be commenced

in December, 1917, and be nearly completed during that month, while the entries covering the retirement of the old building might not be made until January or February, 1918, at the time the new building is completed. Owing to the fact that, especially in the northern part of the United States, not much construction work would be in progress at the first of the calendar year, probably not many of such cases existed, but it is recommended that each accounting officer should examine carefully all work in progress at about that time to determine that the credits for retirements are properly made, either prior to or during Federal control.

From time to time during the period of Federal control, property will be abandoned or retired, and not replaced. It is important that the accounting officer should see that a proper record is made of all such abandoned or retired property which is not replaced, in order that same may be made good at the end of Federal control and that the corporation may receive the proper credit for such property which is abandoned or retired, which is not returned at the end of Federal control. It is unfortunate that the Railroad Administration does not require an authority for the abandonment of every piece of property, because such authority, if required, would provide a good record of all property abandoned. This makes the duty of the corporate accounting officer a little more difficult to perform with regard to property abandoned, but does not relieve him from the responsibility of looking after it in a thorough manner.

Depreciation.

Another point for the accounting officer to bear in mind is that the amounts charged for depreciation during the period of Federal control should be exactly the same as those charged during the test period. In other words, if a railroad charged 4% per annum for depreciation during the entire test period the Administration should charge 4% per annum during the entire period of Federal control on all equipment turned over to the Administration on December 31, 1917. If the rates were changed during the test period, then a proper average of the rates during the test period should be ascertained and that average used during the period of Federal control. The Administration has fixed 4½% as the rate to be charged during Federal control on all equipment acquired by the carriers during Federal control. Letters of the Director General

dated November 25, 1918, and December 3, 1918, state clearly that the amounts charged for depreciation are creditable to the carrier, and may be applied on payments for equipment acquired during the period of Federal control, or for the payment of equipment notes issued prior to Federal control and payable during Federal control. Therefore, the charge for depreciation on equipment during the Federal control period is a direct credit to the corporation, and it is important to see that the rates and computations thereof are made with accuracy and on the right bases.

Miscellaneous Rents.

Another point to be looked after by the corporate accounting officer is the matter of miscellaneous rents for right of way, for buildings and for other purposes. Any such rents that were during the test period properly creditable to the income account of the carrier outside of the accounts included in the standard return, should be collected in cash by the corporation and the money put into the corporate treasury. In some cases this may involve a revision of the standard return. During the test period some roads credited miscellaneous rents to the revenue account, No. 142, which according to the rules of the Interstate Commerce Commission, were creditable to income account No. 510. In such cases, the standard return will be reduced by the U. S. Railroad Administration and such rents during the period of Federal control should be paid over to the corporate treasurer in cash. It is the duty of the accounting officers to see that these rents are properly accounted for, to the end that the revenues of the corporation are fully protected.

Taxes.

Another item to which to give careful attention is the matter of taxes. The accounting officer should see that all taxes (exclusive of war taxes) which were charged to Railway Tax Accruals during the test period and therefore, deducted in arriving at the net railway operating income for the test period, should be paid and assumed by the U. S. Railroad Administration. In order that the corporation revenues may be properly protected, a careful scrutiny of the classes of taxes that were charged to Railway Tax Accruals during the test period, should be made and then all similar payments (not war taxes) during the Federal control period should be charged by the

Railroad Administration against its own expenses, and not against the corporation. The railroad corporations pay so many different kinds of taxes that unless this matter is watched very carefully, the corporation may suffer a loss. In this connection I might say that whenever a voucher is presented to me for approval, whether for taxes or anything else which might have been within the accounts comprising the standard return, I require a certificate by an accountant in my office to the effect that similar items during the test period were not charged against the accounts embraced in the standard return. This necessitates an investigation in connection with each individual payment and I believe is a good way of safeguarding the revenue of the corporation.

Material and Supplies.

Another matter in which the accounting officer is directly interested is the inventory of material and supplies on hand at December 31, 1917, and turned over to the Railroad Administration. The contract provides that at the end of Federal control, such material shall be replaced in like quantity, regardless of whether the prices used in the original inventory may be more or less than those prevailing at the end of Federal control. In other words, the U. S. Railroad Administration contracts to return as many hundred pounds of spikes and as many tons of rails, as many pieces of timber of the various kinds, etc. Therefore, it is important that the inventory should be very carefully preserved, and no sheets thereof lost or misplaced, in order that at the end of Federal control, the proper amount of material and supplies may be turned over to the corporation by the Railroad Administration, or otherwise made good to the corporation. Unless this matter is very carefully watched, the corporation may suffer a severe loss.

Furniture, Fixtures, Tools, Etc.

In addition to the inventory of material and supplies, there should also be an inventory of furniture, fixtures, tools, etc., that have been charged out but are in existence, in order to see that at the end of Federal control, all such furniture, fixtures, tools, office supplies, etc., are returned to the carrier; as, for example, if an office was equipped with 100 desks of a certain type, they should all be returned at the end of Federal control. If only 90 desks are in the office at the end of Federal control, a proper record of the shortage of 10 desks should exist, so

that the Railroad Administration may be called upon to make good the 10 desks which have disappeared.

Price of Fuel, Oil, Etc.

Another point to be watched is the adjustment of prices of fuel, oil, etc., in connection with contracts made under which the corporation obtained reduced prices during the test period. The standard contract, paragraph 8, section 4, provides that the U. S. Railroad Administration shall be substituted for the corporation in such contracts in order that the Administration shall have the benefit during the period of Federal control that the corporation had during the test period. The contract contemplates that such advantage during the period of Federal control shall be only to the extent necessary to offset any increases in the standard return growing out of the reduced prices during the test period. Therefore, it is incumbent upon the accounting officer to see that the reduction in prices during the period of Federal control is sufficient and only sufficient to offset the increase in the standard return due to such reduced prices during the test period. If this matter is not carefuly watched, an unjust settlement which may cause a loss to the corporation or the U. S. Railroad Administration, will result.

Corporate Books to Harmonize With Federal Books.

As to keeping the books of the corporation and of the Federal control, it is recommended that they be kept in complete harmony; that is to say, that an account on the corporate books shall show exactly the same balance due to the Administration as the charge shown on the Federal books against the corporation, and vice versa. If the two sets of books are kept in harmony in that manner, any statements which go to the executive officers or to Washington, from either set of books, will always be in harmony and prevent confusion and useless discussion. It may be that the Federal Auditor will make an errnoneous charge against the corporation, but my recommendation would be that the corporation also record such erroneous charge in order to keep the books in harmony, and then call the matter to the attention of the Federal Auditor, who will make proper correction in his books and concurrently the same correction should be made in the corporate books.

Co-Operation of Corporate and Federal Accounting Officers.

Throughout this paper, reference has been made to the pro-

tection of the revenues of the corporation. This has been done for the reason that the subject assigned to me was "Corporate Accounting during Federal control." The accounts between the U. S. Railroad Administration and the corporations involve hundreds of millions of dollars resulting from transactions which must be recorded on the Federal books. Hence, the Federal accounting officer is interested in protecting the revenues of the corporation to the extent of seeing that all his accounts with the corporation are recorded with the greatest degree of accuracy. From my personal knowledge of the honesty and fair dealing of the railroad accounting officers of the United States, both Federal and corporate, I know that during Federal control the Federal accounting officers have been diligent and faithful in their efforts to record all transactions with the corporations, with the greatest degree of accuracy and thus to render substantial assistance in protecting the revenues of the corporation. If any Federal accounting officer has intentionally deprived the corporation of revenues to which he believed it was justly entitled, whether through erroneous debits or through omission of proper credits, then such accounting officer is unworthy of his profession and is unworthy of membership in this great Association, but I will not believe that such an one exists.

Director of Accounts, U. S. Railroad Administration.

While in this paper I have criticised a few of the accounting provisions of the Administration, it is not intended to create the impression that I think the Administration has a weak accounting department. On the contrary, I think it has a strong accounting department, administered in its details by men of recognized accounting ability. It would be a miracle if all of the accounting provisions of the Administration were beyond criticism. I also want to pay a tribute to Director C. A. Prouty at the head of the Division of Accounts of the U. S. Railroad Administration, in his administration of that department. The magnitude of his duties prevents him from giving attention to details, but the policy of his administration has been broad and fair-minded.

Conclusion.

Many other things could be said with reference to corporate accounting during Federal control; this paper has attempted to touch simply a few of the high spots as they appeared to

the writer. It would be an insult to the intelligence of the many experienced accounting officers if I should attempt to go into the details and try to touch upon every phase of this subject during Federal control. If my paper has resulted in suggesting trains of thought which may be of benefit to the corporations and to the U. S. Railroad Administration, the effort has been amply repaid.